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IN THE

Supreme Court of the United States

OCTOBER TERM, 1942.

No. 48

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE,

Petitioner,

vs.

JOHN STUART,

Respondent.

PETITION BY RESPONDENT FOR REHEARING.

HERBERT POPE,
GEORGE I. HAIGHT,
BENJAMIN M. PRICE,
Counsel for Respondent.

WILLIAM D. MCKENZIE,
Of Counsel.

THE GUNTHORP-WARREN PRINTING COMPANY, 210 WEST JACKSON, CHICAGO

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We respectfully petition this Court for a rehearing in this case.

I.

The order of this Court in reversing the Circuit Court of Appeals and remanding the case to the Board of Tax Appeals for further findings with reference to the application of Section 22(a) of the Revenue Act is based upon a misapprehension of the record before the Board of Tax Appeals. On page 3 of its opinion this Court says:

> "In answer to the taxpayers' petitions for the redetermination of the deficiencies, the Commissioner asserted the increase was required by the provisions of Sections 22, 166 and 167 of the Revenue Act of 1934, 48 Stat. 680."

This is not the fact in No. 48, the John Stuart case, with reference to Section 22. The original claim was based on Section 166. At the hearing and after the decision of this Court in *Helvering* v. *Clifford*, 309 U. S. 331, an amendment to the answer to the petition was made to include Section 167, but, after some discussion, Section 22 was intentionally omitted (R. 11), although it was included in the amendment in No. 49, the R. Douglas Stuart case (R. 12). The right to a finding under Section 22(a) was therefore waived in the John Stuart case at the time of the Board hearing, and the Government brief in the Circuit Court of Appeals, page 30, stated that "Section 22(a) was not relied upon by the Commissioner before the Board of Tax Appeals."

In the Circuit Court of Appeals Government counsel raised the question of the application of Section 22(a) but expressly limited its application to the facts contained in the stipulation. For the purposes of argument we have been willing to discuss in this Court all the possible legal theories involved in the record already made, but the power of the Board to make any special findings with reference to Section 22(a) was barred when this case was before the Board and the question of amendments to the answer was finally determined.

This Court bases its order to remand the case to the Board on the assumption that "When the Board of Tax Appeals decided these cases under Section 166 it was not necessary for it to reach a conclusion on 22(a) or its effect upon Section 167." (Page 10.) This was not in fact the situation before the Board. Even if the Board had been satisfied that the Commissioner's claim could not be sustained under Section 166, the Commissioner's right to have findings made with reference to Section 22(a) had been waived and the Board had no power to deal with that Section. No such power can now be conferred upon it by this Court in view of its decision in *Helvering* v.

Wood, 309 U. S. 344, 348-349. Moreover, in the Court of Appeals the Government attorneys stated that, so far as Section 22(a) was concerned, "the basic facts are those contained in the stipulation."

This Court recognizes in its opinion, page 8, that findings with reference to Section 22(a) could be justified only because that Section had been "pressed continually since this litigation started." In view of the fact that the Commissioner intentionally waived consideration of Section 22(a) when his answer was amended to include Section 167, although he had Section 22(a) in mind and included it in his amendment to his answer in the R. Douglas Stuart case, No. 49, there is no ground upon which it can be claimed that Section 22(a) was pressed continually from the time the litigation started. On the contrary, the Commissioner intentionally left Section 22(a) out of the John Stuart case, and therefore did not assume the burden of proving a case under Section 22(a), which he would have been required to do under Rule 32 of the Board's Rules of Practice if that Section had been included in the amendment to his answer.

We respectfully submit, therefore, that this Court should reconsider its order in this case and should enter an order affirming the judgment of the Circuit Court of Appeals.

II.

If, for some reason which we do not understand, this Court should be still of the opinion that the Board of Tax Appeals is authorized to make special findings with reference to the application of Section 22(a) in this case, then we respectfully ask that this Court first reconsider the consequences of its opinion in this case. We believe its opinion involves a fundamental conflict with prior decisions of this Court, and that this conflict should be resolved before its implications are disclosed to the Board of Tax

Appeals and an unsuspecting public. The conflict concerns not only who owns income but what is income.

We refer first to the statement on page 9 of the opinion, which reads:

> "Economic gain realized or realizable by the taxpayer is necessary to produce a taxable income under our statutory scheme. That gain need not be collected by the taxpayer."

And again on page 10 it is said:

> "In *Corliss* v. *Bowers*, 281 U. S. 376, he (the taxpayer) had disposed of the *res* but with a power to revoke at any moment. This right to realize income by revocation at the settlor's option overcame the technical disposition."

We submit that this theory of taxing a person who does not in fact receive income, instead of the person who has received it in accordance with the applicable state law, because the former has a "realizable" economic gain is in direct conflict with the theory on which "realized" capital gains have been held taxable by this Court while "unrealized" but "realizable" gains have been held not to be taxable. When this question was raised some twenty-two years ago, it was necessary for this Court to consider its decision in the early case of *Gray* v. *Darlington*, 15 Wall. 63. In that case it had been held that increase in the value of an investment through a series of years did not constitute income in any of the years in which the increase occurred nor in the year of the sale. However, in *Merchants Loan & Trust Company* v. *Smietanka*, 255 U. S. 509, and in other cases decided in 1921, it was held that "realizable" gains not in fact realized by a sale or exchange were not taxable, but that gains "realized" through a sale were.

Certainly it is just as easy to sell a marketable security which has increased in value as it is to revoke a trust. It may be easier to sell such a security than it is to persuade a reluctant member of an intimate family group to revoke

or terminate a trust, particularly if there is a question as to his being liable for a breach of trust. Not only that, but in the case of the increase in value of a capital asset the economic gain may be substantially "realized" even without a sale. The increase in value will enable the owner to borrow more money on his capital investment. Certainly the purchaser of land who discovers it possesses oil or gold has a "realizable" gain of a very definite kind. If he is not taxed just because he does not sell it, it must be because "realizable" economic gains do not constitute income for him, or did not until the explicit statement made in the opinion in this case that "realizable" economic gains are included in "our statutory scheme."

There can be no doubt that if this new "realizable" economic gain theory were now to be applied to the increase in the value of capital assets, the industrial life of the country would come to an end almost over night, even in the midst of a war. That is no reason, of course, for rejecting the theory unless the other alternative be deemed to be a better one. It may be less disturbing to the economic welfare of all of us for this Court to reconsider whether the grantor in a trust instrument should be taxed, on account of income actually received and used by a beneficiary, because the grantor might have done but did not do something which would have made him the recipient of the income which was in fact received by the beneficiary.

In *Corliss* v. *Bowers*, 281 U. S. 376, we find the following sentence (p. 378):

> "The acquisition by the wife of the income became complete only when the plaintiff failed to exercise the power that he reserved."

The obvious comment, except for the "realizable" income theory, is to inquire why the wife was not the only person entitled to the income until the power to take it away from her was exercised. Such revocable trusts were the kind of trusts that sensible people made before the

income tax and gift tax era. If conditions remained as expected, there was no reason for a change. If conditions did change, health or financial conditions, there was an opportunity to alter the trust to correspond with changed circumstances. In the meantime, the income of the beneficiary was as fully protected as it could be by the same family solidarity that is now made the reason for taxing the grantor for his enjoyment of "realizable" income. Section 22(a) provides by its terms for the taxation of a person who receives income from an equitable interest in trust property.

We are confronted now with the fact that under the provisions of the same instrument one person may be taxed because he has received and is in possession of "realized" income, and another person may be taxed at the same time for the same income because it is or was a "realizable" economic gain for him. What language is there in Section 22(a) which accomplishes such an extraordinary result as this? If it is not permissible to tax both persons at the same time for the same income, then there must be some language in 22(a) which distinguishes between them and tells when one is to be taxed and when the other. What is it? Where in the "statutory scheme" is there a solution of this problem? Is it always the person with the higher tax? It is certain that the "realizable" income tax theory has no conceivable boundaries and that the possibilities of double taxation for the same income are without limit. The *Merchants Loan & Trust Company* case, *supra*, overruled the half of the decision in *Gray* v. *Darlington*, *supra*, relating to "realized" income and the opinion in this case overrules the other half relating to "realizable" income.

In the *Merchants Loan & Trust Company* case, *supra*, this Court considered that the Sixteenth Amendment as well as Section 22(a) should be interpreted in accordance with what this Court thought the people thought about

income in 1913. Now the new wine of the 1940's is poured into the old 22(a) bottle of 1913 to change and enlarge its meaning even beyond the later express provisions of the 1930's, Sections 166 and 167. The common law rules for the interpretation of tax statutes have been discarded, and, in order to prevent what is called tax avoidance, the meaning of income and the persons to be taxed are subject to constant change under Section 22(a). Both the opinions of the majority and the minority in this case must serve to increase the perplexity of all lawyers and the doubts already expressed by lower federal courts.

No doubt, as this Court says, it is wise to "observe the time-tried admonition of restricting the scope of our decision to the circumstances before us." But a conflict in the decisions of this Court cannot be remedied by the Board of Tax Appeals or the lower federal courts, and too much injustice has been done already to taxpayers in this country by collecting taxes from them based upon inconsistent and conflicting theories. The Board of Tax Appeals cannot settle the scope of the "realizable" income theory by making more findings in this case, and we agree with the statement in the brief of Government counsel in the Circuit Court of Appeals that there are no additional facts which will help to bring this case within any of the Section 22(a) theories so far suggested.

We respectfully ask, therefore, that this Court reconsider its judgment in this case and affirm the judgment of the Circuit Court of Appeals.

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Counsel for Respondent.

WILLIAM D. MCKENZIE,
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I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay.

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Counsel for Respondent.